

QUARTERLY REPORT
FOR THE THIRD QUARTER ENDED 30 SEPTEMBER 2004



Hong Kong Exchanges and Clearing Limited

CONTENTS

	Page
Financial Highlights	1
Business Review and Prospects	2
Condensed Consolidated Profit and Loss Account	13
Condensed Consolidated Statement of Changes in Equity	14
Condensed Consolidated Balance Sheet	15
Notes to the Condensed Consolidated Accounts	17
Other Information	38

FINANCIAL HIGHLIGHTS

(Financial figures are expressed in Hong Kong dollars)

	Unaudited Nine months ended 30 Sept			Unaudited Three months ended 30 Sept		
	2004	2003	Change	2004	2003	Change
KEY MARKET STATISTICS						
Average daily turnover value on the Stock Exchange	\$15.3 billion	\$8.8 billion	74%	\$12.3 billion	\$12.0 billion	3%
Average daily number of derivatives contracts traded on the Futures Exchange	57,078	41,316	38%	55,981	45,541	23%
Average daily number of stock options contracts traded on the Stock Exchange	22,569	15,199	48%	20,995	16,313	29%
	\$'000	\$'000		\$'000	\$'000	
RESULTS						
Income	1,736,580	1,401,163	24%	569,718	494,115	15%
Operating expenses	847,579	934,267	(9%)	281,952	273,576	3%
Operating profit	889,001	466,896	90%	287,766	220,539	30%
Share of profits less losses of associated companies	8,871	4,647	91%	2,706	1,384	96%
Profit before taxation	897,872	471,543	90%	290,472	221,923	31%
Taxation	(142,204)	(67,247)	111%	(39,797)	(32,013)	24%
Profit attributable to shareholders	755,668	404,296	87%	250,675	189,910	32%
Shareholders' funds	3,714,916	5,603,263	Φ (34%)	3,714,916	5,603,263	Φ (34%)
Total assets *	18,070,208	19,802,264	Φ (9%)	18,070,208	19,802,264	Φ (9%)
Net assets per share # Ω	\$3.52	\$5.34	Φ (34%)	\$3.52	\$5.34	Φ (34%)
Earnings per share	\$0.717	\$0.387	85%	\$0.237	\$0.181	31%

* The Group's total assets include the margin funds received from Participants on futures and options contracts.

Φ Audited as at 31 December 2003.

Based on 1,056,592,846 shares issued and fully paid as at 30 September 2004 (31 December 2003: 1,048,998,846 shares).

Ω The drop in net assets per share is mainly attributable to the payment of 2003 special dividend of \$1.68 per share, 2003 final dividend of \$0.42 per share and 2004 interim dividend of \$0.43 per share, totalling \$2.53 per share.

BUSINESS REVIEW AND PROSPECTS

Business and Market Developments

(Financial figures are expressed in Hong Kong dollars)

Hong Kong Exchanges and Clearing Limited (HKEx) reports below its business activities during the three months to 30 September this year and its financial performance for the third quarter and the first three quarters of the year.

Market Activity

Average daily turnover value on The Stock Exchange of Hong Kong Limited (the Stock Exchange) during the period under review was \$12.3 billion (2004 first three quarters: \$15.3 billion), compared with \$12.0 billion in the third quarter of 2003. A total of nine equity issues were newly listed on the Main Board, including one by a company formerly listed on the Growth Enterprise Market (GEM), and five were listed on GEM (2004 first three quarters: 32 on the Main Board and 20 on GEM). In the third quarter of 2003, there were 15 equity issues newly listed on the Main Board, including one by a company formerly listed on GEM, and six on GEM. Equity capital formation through initial public offering (IPO) and post-IPO fund-raising totalled \$9.2 billion on the Main Board and \$943.6 million on GEM (2004 first three quarters: \$219.5 billion on the Main Board and \$4.9 billion on GEM), compared with a total of \$17.8 billion on the Main Board and \$2.0 billion on GEM in the third quarter of 2003.

The average daily number of futures and options contracts traded on the Hong Kong Futures Exchange Limited (the Futures Exchange) and the Stock Exchange during the period under review was 76,976 (2004 first three quarters: 79,647), up from 61,854 in the third quarter of 2003. Total open interest at the end of September 2004 was 755,391 contracts, compared with 541,247 contracts at the end of September 2003.

Listing

Enhancement of Corporate Governance

The Listing Committee (comprised of members of the Main Board and GEM Listing Committees), at its September quarterly policy meeting, agreed the final form of the revised Code on Corporate Governance Practices and the disclosure requirements relating to the Report on Corporate Governance practices. The revised Code and related rule amendments have been approved by the Securities and Futures Commission (the SFC) and will be published in the middle of November.

Regulation of Sponsors and Independent Financial Advisers

On 19 October, HKEx and the SFC jointly published Consultation Conclusions on the Regulation of Sponsors and Independent Financial Advisers along with amendments to the Listing Rules (Main Board and GEM). The rule amendments will take effect on 1 January 2005 and transitional arrangements will be put in place where considered necessary. The amendments will implement many of the consultation conclusions; most significantly, they will codify HKEx's current expectations concerning the role of sponsors, including the due diligence sponsors would typically perform in relation to initial listing applications.

Consultation on the Proposed Reduction of Minimum Trading Spreads in the Securities Market

On 6 August, HKEx published its Consultation Paper on the Reduction of Minimum Spreads to invite market views and comments. In developing the proposals, HKEx considered the characteristics of Hong Kong's securities market and the current market arrangements. The suggested reduction of the minimum spreads is aimed at increasing the competitiveness of our market, improving market efficiency and enhancing market liquidity. The proposals would also make the spreads more uniform.

HKEx believes that changes in minimum spreads should be implemented cautiously. Therefore, a phased approach has been proposed. Under Phase 1 of the proposal, minimum spreads for shares priced above \$30 would be reduced. Phase 2, which would depend on the successful implementation of Phase 1, comprises two options for further changes. In addition, the consultation paper invited alternative proposals.

The consultation period ended on 6 October. HKEx has received 462 submissions and is now reviewing the responses.

Products and Services

Enhanced CCASS Investor Account Service

HKEx introduced enhanced features of the Investor Account Service in the Central Clearing and Settlement System (CCASS) on 23 August along with promotion programmes. The Investor Account Service provides investors with an additional choice for custody of their stockholdings with the benefits of electronic book-entry settlement. The service has been upgraded periodically since its introduction in 1998.

The enhancements, which are in response to market demand, include an extended online window for CCASS Phone System and Internet users, access to the CCASS Internet System via ID and password, alert message service (via SMS, or short message service), streamlined stock transfer instructions, upgraded voting functions and electronic statement service. The changes have made the service more convenient, easier to use and easier to support.

The promotion programmes were designed to increase public awareness of the Investor Account Service. They include free trials of selected services, an incentive scheme for new and existing account holders and lucky draws. The promotion period ends on 31 December.

Callable Bull/Bear Contracts

HKEx is considering introducing Callable Bull/Bear Contracts (CBBCs) as a new category of structured products, and it has been working to develop a suitable market infrastructure. CBBCs track the performance of an underlying asset and are somewhat similar to margin financing. They can be issued as either Bull or Bear instruments, allowing investors to take bullish or bearish positions on the underlying asset – a single stock, index, or commodity – with a small capital outlay.

HKEx is discussing with the SFC on the possible introduction of CBBCs. In addition, it has had discussions on CBBCs with issuers, overseas exchanges that offer the product and market practitioners in Hong Kong, including issuers, brokers and industry associations.

MOU with China Securities Depository and Clearing Corporation

Hong Kong Securities Clearing Company Limited, a wholly-owned subsidiary of HKEx, and the China Securities Depository and Clearing Corporation signed a Memorandum of Understanding (MOU) in Beijing on 17 September. The MOU covers the exchange of information and personnel, and further strengthens HKEx's ties with its counterparts on the Mainland.

Conferences on the Mainland

HKEx and the Research Centre of the State-owned Assets Supervision and Administration Commission of the State Council co-organised a conference in Shanghai on 2 September to promote the listing of state-owned enterprises on HKEx's markets and the role of Hong Kong as the premier international capital formation centre for Mainland enterprises. Executives from about 200 Mainland enterprises, including many state-owned enterprises, attended the conference. The other participants included representatives from the Hong Kong offices of international accounting firms, law firms and investment banks.

HKEx also participated in Hong Kong Financial Services Expo 2004 in Shanghai, a three-day event in the second half of September organised by the Hong Kong Trade Development Council.

Stock Exchange Trading Hall

On 5 November, the Board approved in principle a plan to retain the Trading Hall of the Stock Exchange and make it a multi-purpose facility. Implementation of the plan is subject to successful renewal of the lease, which will expire in October next year.

Under the plan, HKEx will renovate the Trading Hall to create space for new facilities. These will include areas for listing ceremonies, visitors, public exhibitions and broadcasting booths for the news media. In addition, there will be multi-function rooms and facilities for annual general meetings, investor education and market events.

HKEx proposes charging Exchange Participants for occupying and using the upgraded trading booths on a user-pays basis and plans to consult the market on the proposal. The proposal, including any new fee charges, will require the approval of the SFC.

Views on Estate Duty and Taxing of Securities Dealings

HKEx submitted a response to the Government's consultation paper on estate duty review and one on exempting securities dealings from profits tax on 19 September and 28 October respectively. HKEx supports the abolition of estate duty. It also supports the Government's initiative to exempt offshore funds from profits tax and recommends expanding the exemption to all dealings in Hong Kong-listed securities.

Finance

The Finance Department supervises the investment of funds, which can be divided into three main categories: Corporate Funds (comprising mainly share capital and retained earnings of the Group), Clearing House Funds and margin funds received (which exclude contributions receivable from Participants and securities deposited by Participants as alternatives to cash deposits of margin funds).

An Investment Advisory Committee, comprised of non-executive Directors of HKEx and an external member from the financial community, advises the Board on portfolio management and monitors the risk and performance of HKEx's investments. A Treasury team in the Finance Department is dedicated to the day-to-day management and investment of the funds. Three external fund managers have also been appointed to manage part of the Corporate Funds since July 2001.

Investment and fund management is governed by investment policies and risk management parameters approved by the Board. Investment restrictions and guidelines form an integral part of risk control. Fund-specific restrictions and guidelines are set according to the investment objectives of each fund. In addition, specific limits are set for each fund to control risk (e.g. permissible asset type, asset allocation, liquidity, credit, counterparty concentration, maturity, foreign exchange, interest rate and market risks) of the investments.

The investment objective of the Corporate Funds is the provision of liquidity for funding ongoing operations and long-term capital preservation. Accordingly, the funds can be invested in cash, money market instruments, bonds, collective investment schemes and equities. Only the external fund managers are permitted, subject to compliance with guidelines on conflict of interest and to limits forming part of the investment policies, to invest in equities, which include convertible bonds. For Clearing House Funds and margin funds, the investment objective of which is to satisfy liquidity requirements and safeguard the financial assets of the funds, their portfolios only consist of cash, money market instruments and bonds.

For the nine months ended 30 September 2004, the average amount of funds available for investment increased by 40 per cent or \$4.00 billion to \$13.91 billion (2003: \$9.91 billion), primarily due to a rise in margin funds received from Participants as a result of increased open interest in futures and options contracts, which was partly offset by the reduction in Corporate Funds following the \$2.22 billion payment of 2003 special and final dividends in April 2004. Comparing with 30 June 2004, the overall fund size as of 30 September 2004 increased by 8 per cent or \$1.02 billion to \$13.54 billion (30 June 2004: \$12.52 billion).

As at 30 September 2004 and 30 June 2004, details of the asset allocation were as follows:

	Fund size \$ billion		Bonds		Cash or bank deposits		Global equities	
	Sept	Jun	Sept	Jun	Sept	Jun	Sept	Jun
Corporate Funds	3.36	3.46	72%	68%	22%	25%	6%	7%
Margin funds	8.74	7.96	37%	41%	63%	59%	0%	0%
Clearing House Funds	1.44	1.10	9%	11%	91%	89%	0%	0%
Total	13.54	12.52	43%	46%	56%	52%	1%	2%

Investments of the three funds are kept sufficiently liquid to meet HKEx's operating needs and possible liquidity requirements of the Clearing House Funds and margin funds. Excluding equities held under the Corporate Funds (\$0.21 billion as at 30 September 2004 and \$0.24 billion as at 30 June 2004), which do not have a maturity date, the maturity profile of the remaining \$13.33 billion and \$12.28 billion of investments as at 30 September 2004 and 30 June 2004 was as follows:

	Fund size \$ billion		Overnight		>Overnight to 1 month		>1 month to 1 year		>1 year to 3 years		> 3 years	
	Sept	Jun	Sept	Jun	Sept	Jun	Sept	Jun	Sept	Jun	Sept	Jun
Corporate Funds	3.15	3.22	16%	17%	8%	11%	23%	22%	35%	36%	18%	14%
Margin funds	8.74	7.96	38%	45%	21%	8%	14%	12%	27%	35%	0%	0%
Clearing House Funds	1.44	1.10	78%	76%	3%	0%	8%	10%	11%	14%	0%	0%
Total	13.33	12.28	37%	40%	16%	9%	16%	14%	27%	33%	4%	4%

Credit exposure was well diversified. As at 30 September 2004, all bonds held were of investment grade and had a weighted average credit rating of Aa2 (30 June 2004: Aa2) and a weighted average maturity of 1.5 years (30 June 2004: 1.6 years). Deposits were placed only with the note-issuing banks in Hong Kong and licensed banks and restricted licence banks with a minimum credit rating of A3 by Moody's or equivalent approved by the Board from time to time.

Risk management techniques, such as Value-at-Risk (VaR) and portfolio stress testing, are used to identify, measure, monitor and control market risks. VaR measures the expected maximum loss over a given time interval (a holding period of 10 trading days is used by HKEx) at a given confidence level (95 per cent confidence interval is adopted by HKEx) based on historical data (one year is used by HKEx). The overall risk, as measured by the VaR methodology, during the second quarter and third quarter was as follows:

	Average VaR \$ million		Maximum VaR \$ million		Minimum VaR \$ million	
	Jul-Sept	Apr-Jun	Jul-Sept	Apr-Jun	Jul-Sept	Apr-Jun
Corporate Funds	15.77	16.26	17.25	17.56	14.65	14.02
Margin funds	15.90	16.85	16.84	17.44	15.03	15.67
Clearing House Funds	1.06	1.15	1.14	1.24	0.99	1.01

For details of HKEx's investment income, please refer to the Overall Performance section and note 6 to the accounts of this quarterly report.

Overall Performance

(Financial figures are expressed in Hong Kong dollars)

The Group recorded a profit attributable to shareholders of \$756 million for the nine months ended 30 September 2004 (2004 first quarter: \$314 million; 2004 second quarter: \$191 million; 2004 third quarter: \$251 million), compared with \$404 million for the same period in 2003 (2003 first quarter: \$89 million; 2003 second quarter: \$125 million; 2003 third quarter: \$190 million).

Income, in particular trading fees and trading tariff, and clearing and settlement fees, increased due to a higher level of activity in the cash and derivatives markets during the nine-month period ended 30 September 2004 compared with the same period in 2003. This was, however, partly offset by a drop in investment income mainly due to reduced interest income on account of lower interest rates during the current period and the distribution of the 2003 special and final dividends of \$2.2 billion in the second quarter of 2004, and the decline in bond and equity prices in the second quarter of 2004 as the markets reacted negatively to concerns over interest rate increases and macro-economic measures by Mainland authorities to slow credit growth in certain sectors.

Total operating expenses for the first nine months declined by \$86 million or 9 per cent to \$848 million (2003: \$934 million), which was mainly due to the non-recurring one-off costs incurred in the second quarter of 2003 (\$52 million less tax deduction of \$1 million), and savings in information technology and computer maintenance expenses and legal and professional fees during the current period. Taxation in 2003 also included a one-off increase in deferred tax charge of \$6 million following the implementation of the new Hong Kong Statement of Standard Accounting Practice 12: Income Taxes and the increase in Profits Tax rate.

Income

Total income (including share of profits less losses of associated companies) for the period increased by \$340 million or 24 per cent to \$1,746 million (2003: \$1,406 million).

Activity on the cash market experienced considerable volatility during the nine-month period under review. The improved market sentiment in the second half of 2003 gained more momentum in the first quarter of 2004, but macro-economic measures introduced to adjust the Mainland economy, high oil prices and the interest rate rise in the United States caused trading to edge down in the second quarter. Trading activities started to pick up again in August 2004 as the property market resumed its rebound. The average daily turnover on the Stock Exchange for the nine-month period rose by 74 per cent to \$15.3 billion compared with \$8.8 billion in the corresponding period last year. Average daily number of stock options contracts traded on the Stock Exchange during the first nine months of 2004 increased by 48 per cent compared to the same period of 2003. Moreover, the average daily number of derivatives contracts traded on the Futures Exchange increased by 38 per cent, which was mainly attributable to the increase in the trading of Hang Seng Index Futures contracts and the launch of H-Shares Index Futures in December 2003. Consequently, trading fees rose by \$172 million or 53 per cent to \$495 million (2003: \$323 million).

Listing fee income increased by \$28 million or 12 per cent to \$271 million (2003: \$243 million), primarily due to an increase in initial listing fees as the number of newly listed derivative warrants rose to 869 in 2004 (2003: 402), and a rise in annual listing fees on account of a higher number of listed securities. There were 32 (2003: 31) and 20 (2003: 18) new listings on the Main Board and GEM respectively during the nine-month period ended 30 September 2004. As at 30 September 2004, nine Main Board and three GEM (31 December 2003: three Main Board and five GEM) IPO applications had obtained approval in principle from the Listing Committee for listing, and 43 Main Board and 22 GEM applications were being processed (31 December 2003: 19 Main Board and 32 GEM). As at 30 September 2004, there were 877 companies listed on the Main Board and 203 on GEM (31 December 2003: 852 and 185 respectively).

In line with the growth in cash market activity, clearing and settlement fee income increased by 54 per cent or \$91 million to \$259 million in the first nine months (2003: \$168 million), and depository, custody and nominee services fees moved up by 27 per cent or \$39 million to \$182 million during the nine-month period ended 30 September 2004 (2003: \$143 million).

Income from sale of information for the first nine months rose by \$38 million or 20 per cent to \$230 million (2003: \$192 million), as demand for information increased in tandem with the activities of the cash and derivatives markets.

Investment income comprises income from investments supervised by the Finance Department, investment in Singapore Exchange Limited and accommodation income from Participants. Total investment income for the period fell by \$55 million or 24 per cent to \$170 million (2003: \$225 million), predominantly due to lower interest rates during the period.

For investments supervised by the Finance Department, income for the period amounted to \$140 million, 34 per cent or \$72 million lower than the \$212 million for the same period in 2003. The decrease was attributable to the reduced gains of \$26 million or 53 per cent from \$49 million in 2003 to \$23 million in 2004 due to market movements. Also, net interest income was lower at \$112 million (2003: \$160 million) due to lower interest rates and reduced Corporate Funds available for investment following the \$2.2 billion payment of 2003 special and final dividends in April 2004.

During the period under review, the average 6-month Hong Kong Exchange Fund Bill rate dropped from 1.04 per cent in 2003 to 0.48 per cent in 2004, and the average 90-day US Treasury Bill rate rose from 1.04 per cent to 1.16 per cent.

For the nine months ended 30 September 2004, on an annualised basis, the Finance Department achieved a positive return on investments of 1.35 per cent (2003: 2.86 per cent). The Corporate Funds returned 2.74 per cent (2003: 4.17 per cent), the margin funds 0.76 per cent (2003: 1.65 per cent), and the Clearing House Funds 0.72 per cent (2003: 1.88 per cent). Therefore, the overall portfolio recorded a spread of 87 basis points (2003: 182 basis points), with Corporate Funds registering a spread of 226 basis points (2003: 313 basis points), the margin funds 28 basis points (2003: 61 basis points) and the Clearing House Funds 24 basis points (2003: 84 basis points) above the 6-month Hong Kong Exchange Fund Bill yield.

The average amount of funds available for investment during the period increased by 40 per cent or \$4.0 billion to \$13.9 billion (2003: \$9.9 billion), primarily due to a rise in margin funds received from Participants as a result of increased open interest in futures and options contracts, which was partly offset by the reduction in Corporate Funds following the \$2.2 billion payment of 2003 special and final dividends in April 2004. As at 30 September 2004, 56 per cent (31 December 2003: 59 per cent) of the funds were invested in cash and bank deposits, 43 per cent (31 December 2003: 39 per cent) in high-grade bonds with an average credit rating of Aa2, and 1 per cent (31

December 2003: 2 per cent) in global equities. For more details of the investment portfolio, please refer to the Finance section under Business and Market Developments.

Accommodation income (i.e. retention interest charged on cash margin deposits in non-contract settlement currencies and securities deposited by Participants as alternatives to cash deposits of the margin funds) dropped by 63 per cent or \$8 million to \$4 million (2003: \$12 million) as cash margin deposits in Japanese Yen and US Treasury bills deposited dropped significantly during the period. Income from the investment in Singapore Exchange Limited for the first nine months increased by \$25 million to \$26 million (2003: \$1 million) mainly due to the profit arising from the disposal of the investment in July 2004 of approximately \$24.8 million.

Other income rose by \$23 million or 21 per cent to \$130 million (2003: \$107 million), mainly due to a \$11 million increase in brokerage on direct IPO applications, and an increase in terminal, dataline and network usage fees and software sub-license fees of \$13 million.

Share of profits less losses of associated companies increased by \$4 million or 91 per cent to \$9 million (2003: \$5 million), due to the improved performance of one of the associated companies, Computershare Hong Kong Investor Services Limited, during the period under review.

Operating Expenses

Total operating expenses for the period under review declined by 9 per cent or \$86 million to \$848 million (2003: \$934 million).

Staff costs and related expenses remained stable at \$389 million (2003: \$390 million). Savings of one-off severance costs (\$9 million incurred on the reorganisation and streamlining of the Group's operations in 2003) and lower salary costs as a result of reduced headcount in 2004 were offset by an accrual for performance bonus on account of the Group's improved performance in 2004.

Information technology and computer maintenance expenses for the first nine months dropped by \$25 million or 13 per cent to \$167 million in 2004 (2003: \$192 million), mainly attributable to lower hardware rental. During the period under review, capital expenditures on computer systems, hardware and software amounted to \$16 million (2003: \$21 million).

Premises expenses fell by 7 per cent or \$5 million to \$59 million (2003: \$64 million) as lower rental was negotiated upon the renewal of certain leases and savings achieved from reduced floor area leased during the first nine months of 2004.

Product marketing and promotion expenses rose by \$3 million or 67 per cent to \$8 million (2003: \$5 million). The increase was mainly attributable to higher expenditure in corporate marketing and advertising campaigns, and incentive programmes for the promotion of the H-Shares Index Futures and Options and services for Investor Participants.

Legal and professional fees for the period decreased by \$16 million or 67 per cent to \$8 million (2003: \$24 million). The fall was mainly attributable to professional fees incurred for several one-off consulting projects in the first nine months of 2003.

Depreciation and amortisation costs remained fairly stable at \$139 million (2003: \$139 million). The increase in depreciation attributable to the rollout of DCASS, the Derivatives Clearing and Settlement System, in April 2004 was offset by the decrease arising from the revision to the estimated useful life of the hardware of trading and clearing systems from three years to five years to better reflect the useful life of the equipment.

Payment to the SFC was \$15 million for the first nine months of 2004 (2003: \$10 million) under the dual filing regime, which started from 1 April 2003.

Other operating expenses dropped by \$47 million or 43 per cent to \$63 million (2003: \$110 million), mainly attributable to certain one-off costs incurred in 2003 (\$32 million for the write-down of the Group's investment in BondsInAsia Limited and \$10 million of retirement of redundant IT systems following the review of its business strategy and operations in May 2003), as well as a devaluation deficit of \$4 million of one of the Group's properties charged to the profit and loss account in 2003. Provision for doubtful debts fell by \$4 million compared with 2003.

Taxation

The Group's tax charge rose by \$75 million or 111 per cent to \$142 million (2003: \$67 million), principally due to a rise in tax charge resulting from an increase in profit before taxation in 2004.

Comparison of 2004 Third Quarter Performance with 2004 Second Quarter Results

Profit attributable to shareholders was \$251 million for the third quarter of 2004, \$60 million or 31 per cent higher than the \$191 million registered in the second quarter of 2004. The improvement in profit was mainly attributable to a \$51 million or 10 per cent increase in income.

The decline in activity in the cash market continued in the third quarter and bottomed out in August. The average daily turnover on the Stock Exchange for the third quarter fell by 11 per cent to \$12.3 billion compared with \$13.8 billion in the second quarter. This has led to a decrease in trading fees and trading tariff of \$7 million, clearing and settlement fees of \$7 million and income from sale of information of \$6 million compared with the second quarter. In addition, depository, custody and nominee services fees fell by \$31 million mainly due to a decrease in dividend collection and scrip fee income due to seasonal factors.

On the other hand, investment income recovered from a loss of \$13 million in the second quarter to a profit of \$90 million in the third quarter, mainly attributable to the recovery of the bond and equity markets in the third quarter after the significant drop in April 2004, and the disposal of the investment in Singapore Exchange Limited in July 2004 at a profit over cost of approximately \$24.8 million.

Total operating expenses has remained fairly stable at \$282 million during the two quarters under review.

Tax charge dropped by \$8 million to \$40 million in the third quarter (2004 second quarter: \$48 million) despite an increase in profit before taxation. The \$51 million of higher profit before taxation in the third quarter only brought in an additional \$2 million of tax charge as a large part of the increase in profit was non-taxable (mainly investment income, of which \$24.8 million relates to the sale of investment in Singapore Exchange Limited). This was, however, more than offset by \$10 million of lower tax charge in the third quarter due to higher utilisation of tax losses, whereas in the second quarter, certain entities of the Group were making tax losses due to the fall in the bond and equity markets.

Working Capital

Working capital fell by \$1,427 million or 35 per cent to \$2,643 million as at 30 September 2004 (31 December 2003: \$4,070 million). The decline was primarily due to the payment of the 2003 special and final dividends of \$2,219 million and the 2004 interim dividend of \$454 million, which was partly offset by \$756 million of profit generated during the nine-month period, the proceeds on sale of investment in Singapore Exchange Limited of \$76 million and \$307 million of time deposits brought forward from 31 December 2003 with maturity over one year that became current assets during the period due to the lapse of time.

Significant Investments Held and Material Acquisitions and Disposals

The Group disposed of its entire investment in Singapore Exchange Limited included under non-trading securities in July 2004 at a profit over cost of approximately \$24.8 million.

The Group has resolved to liquidate its investment in ADP Wilco Processing Services Limited (“AWPS”, book value as at 30 September 2004: \$1.3 million, representing the Group’s share of AWPS’s net assets, which comprise predominantly cash and bank balances). The liquidation proceeds are expected to approximate the investment book value. Both shareholders of AWPS agree to the liquidation.

Exposure to Fluctuations in Exchange Rates and Related Hedges

When seeking to optimise returns on its funds available for investment, the Group may invest in non-HKD securities from time to time. During the period, the Singapore dollar credit facility (31 December 2003: S\$11 million or HK\$50 million) used to hedge the currency exposure of the Group’s investment in shares of Singapore Exchange Limited was fully repaid. Thereafter, only forward foreign exchange contracts are used to hedge the currency exposure of the Group’s non-HKD investments to mitigate risks arising from fluctuations in exchange rates. As at 30 September 2004, aggregate net open foreign currency positions amounted to HK\$2,013 million, of which HK\$208 million were non-USD exposures (31 December 2003: HK\$1,663 million, of which HK\$204 million were non-USD exposures). The Group’s foreign currency liabilities, in the form of margin deposits or collateral received, are hedged by investments in the same currencies.

There were no other significant changes in the financial position or from the information disclosed under Management Discussion and Analysis in the annual report for the year ended 31 December 2003.

It is the Group’s plan to declare dividend only at the half-year and year-end. Therefore, no dividend will be proposed for the third quarter ended 30 September 2004 (third quarter of 2003: \$Nil).

Due to fluctuations in market conditions and changes in operating environment, certain categories of income and operating expenses may vary from quarter to quarter. Therefore, quarterly results should not be extrapolated to project the full-year performance of the Group.

Prospects

As a substantial part of HKEx's income is derived from trading fees and trading tariff, clearing and settlement fees, listing fees and interest income, the performance of the Group is heavily influenced by external factors including, in particular, market sentiment, the level of activity on the Stock Exchange and the Futures Exchange, and movement in interest rates. Although activity on the cash and derivatives markets has picked up again after the sluggish performance in May through August, market sentiment may be adversely affected by high oil prices, slower than expected economic recovery in the US, and any additional macro-economic measures adopted by Mainland authorities to further adjust their economy.

HKEx will continue its efforts to improve the quality of its markets and attract more high quality companies to list in Hong Kong, with particular focus on companies in Mainland China. It will also continue to exercise stringent cost control and target its resources at meeting market needs.

CONDENSED CONSOLIDATED PROFIT AND LOSS ACCOUNT

(Financial figures are expressed in Hong Kong dollars)

		Unaudited Nine months ended 30 Sept		Unaudited Three months ended 30 Sept	
	Note	2004 \$'000	2003 \$'000	2004 \$'000	2003 \$'000
INCOME	2				
Trading fees and trading tariff	4	494,610	323,222	147,438	138,713
Stock Exchange listing fees	5	271,314	242,642	88,344	82,583
Clearing and settlement fees		258,438	167,592	72,488	75,280
Depository, custody and nominee services fees		181,887	143,156	56,730	48,563
Income from sale of information		230,250	192,038	71,910	65,785
Investment income	6	170,292	225,187	89,921	46,897
Other income	7	129,789	107,326	42,887	36,294
	3	<u>1,736,580</u>	<u>1,401,163</u>	<u>569,718</u>	<u>494,115</u>
OPERATING EXPENSES					
Staff costs and related expenses		388,534	390,433	129,283	123,572
Information technology and computer maintenance expenses		166,643	192,348	56,626	54,895
Premises expenses		58,890	63,570	19,919	20,737
Product marketing and promotion expenses		7,853	4,705	2,157	1,363
Legal and professional fees		7,968	24,385	2,484	3,394
Depreciation and amortisation		139,488	138,863	46,968	45,838
Payment to SFC under dual filing regime		15,000	10,000	5,000	5,000
Other operating expenses	8	63,203	109,963	19,515	18,777
	3	<u>847,579</u>	<u>934,267</u>	<u>281,952</u>	<u>273,576</u>
OPERATING PROFIT	3	889,001	466,896	287,766	220,539
SHARE OF PROFITS LESS LOSSES OF ASSOCIATED COMPANIES	3	8,871	4,647	2,706	1,384
PROFIT BEFORE TAXATION	3	897,872	471,543	290,472	221,923
TAXATION	3 / 9	(142,204)	(67,247)	(39,797)	(32,013)
PROFIT ATTRIBUTABLE TO SHAREHOLDERS	3 / 22	<u>755,668</u>	<u>404,296</u>	<u>250,675</u>	<u>189,910</u>
Earnings per share	10	<u>\$0.717</u>	<u>\$0.387</u>	<u>\$0.237</u>	<u>\$0.181</u>

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
(Financial figures are expressed in Hong Kong dollars)

	Note	Unaudited Nine months ended 30 Sept 2004 \$'000	Unaudited Nine months ended 30 Sept 2003 \$'000
Total equity at 1 Jan		<u>5,603,263</u>	<u>5,490,364</u>
Change in valuation of investment property		-	(200)
Change in valuation of other properties		22,107	(8,271)
Change in fair value of non-trading securities		(24,693)	26,943
Deferred tax arising from change in valuation of other properties		(3,870)	763
Deferred tax arising from change in fair value of non-trading securities		<u>3,462</u>	<u>868</u>
Net (deficit)/surplus not recognised in the condensed consolidated profit and loss account		(2,994)	20,103
Profit attributable to shareholders		755,668	404,296
Realisation of change in fair value of non-trading securities on maturity or disposal		(25,190)	(6,399)
2003 special and final dividends / 2002 final dividend		(2,202,898)	(448,740)
2004/2003 interim dividend		(454,283)	(188,452)
Dividend on shares issued for employee share options exercised after declaration of 2003 special and final dividends /2002 final dividend		(15,661)	(647)
Dividend on shares issued for employee share options exercised after declaration of 2004/2003 interim dividend		(8)	(231)
Proceeds from issue of shares under employee share option schemes	19	<u>57,019</u>	<u>36,607</u>
Total equity at 30 Sept		<u><u>3,714,916</u></u>	<u><u>5,306,901</u></u>

CONDENSED CONSOLIDATED BALANCE SHEET

(Financial figures are expressed in Hong Kong dollars)

		Unaudited at 30 Sept 2004 \$'000	Audited at 31 Dec 2003 \$'000
NON-CURRENT ASSETS			
Fixed assets	11	485,348	585,627
Investments in associated companies	12	32,581	34,002
Clearing House Funds	13	1,554,491	1,551,330
Compensation Fund Reserve Account	14	37,080	36,859
Cash and Derivatives Market Development Fund	15	412	925
Non-trading securities		-	77,258
Time deposits with maturity over one year		85,990	393,456
Deferred tax assets		983	-
Other assets		13,195	4,814
		<u>2,210,080</u>	<u>2,684,271</u>
CURRENT ASSETS			
Margin funds on derivatives contracts	16	9,665,847	7,874,510
Accounts receivable, prepayments and deposits	17	2,965,658	4,644,680
Taxation recoverable		961	1,558
Trading securities		2,608,483	3,212,998
Bank balances and time deposits		619,179	1,384,247
		<u>15,860,128</u>	<u>17,117,993</u>
CURRENT LIABILITIES			
Bank loans		-	50,286
Margin deposits and securities received from			
Clearing Participants on derivatives contracts	16	9,665,847	7,874,510
Accounts payable, accruals and other liabilities	17	3,199,220	4,779,904
Participants' admission fees received		3,250	4,100
Deferred revenue		111,790	257,068
Taxation payable		213,184	57,370
Provisions	18	23,692	25,011
		<u>13,216,983</u>	<u>13,048,249</u>
NET CURRENT ASSETS		<u>2,643,145</u>	<u>4,069,744</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		<u>4,853,225</u>	<u>6,754,015</u>

CONDENSED CONSOLIDATED BALANCE SHEET (continued)

(Financial figures are expressed in Hong Kong dollars)

		Unaudited at 30 Sept 2004 \$'000	Audited at 31 Dec 2003 \$'000
NON-CURRENT LIABILITIES			
Participants' admission fees received		84,050	84,950
Participants' contributions to Clearing House Funds		986,252	984,045
Deferred tax liabilities		43,923	58,665
Provisions	18	24,084	23,092
		1,138,309	1,150,752
NET ASSETS			
		3,714,916	5,603,263
CAPITAL AND RESERVES			
Share capital	19	1,056,593	1,048,999
Share premium	19	103,763	54,338
Revaluation reserves	20	18,247	46,431
Designated reserves	21	688,393	689,657
Retained earnings	22	1,847,920	1,560,940
Proposed and declared dividends	22	-	2,202,898
SHAREHOLDERS' FUNDS			
		3,714,916	5,603,263

NOTES TO THE CONDENSED CONSOLIDATED ACCOUNTS

(Financial figures are expressed in Hong Kong dollars)

1. Basis of Preparation and Accounting Policies

These unaudited condensed consolidated accounts should be read in conjunction with the 2003 annual accounts.

The accounting policies and methods of computation used in the preparation of these accounts are consistent with those used in the annual accounts for the year ended 31 December 2003.

2. Turnover

Turnover comprises trading fees and trading tariff from securities and options traded on The Stock Exchange of Hong Kong Limited (the Stock Exchange) and derivatives contracts traded on Hong Kong Futures Exchange Limited (the Futures Exchange), Stock Exchange listing fees, clearing and settlement fees, depository, custody and nominee services fees, income from sale of information, investment income (including investment income net of interest expenses of Clearing House Funds) and other income, which are **disclosed as Income** in the condensed consolidated profit and loss account.

3. Segment Information

The Group's income is derived solely from business activities in Hong Kong. An analysis of the Group's income and results for the period by business segments is as follows:

	Unaudited Nine months ended 30 Sept 2004				
	Cash Market \$'000	Derivatives Market \$'000	Clearing Business \$'000	Information Services \$'000	Group \$'000
Income	757,370	240,438	506,836	231,936	1,736,580
Costs	<u>395,108</u>	<u>107,234</u>	<u>287,697</u>	<u>57,540</u>	<u>847,579</u>
Segment results	362,262	133,204	219,139	174,396	889,001
Share of profits less losses of associated companies	<u>(1)</u>	<u>-</u>	<u>8,872</u>	<u>-</u>	<u>8,871</u>
Segment profits before taxation	362,261	133,204	228,011	174,396	897,872
Taxation					<u>(142,204)</u>
Profit attributable to shareholders					<u><u>755,668</u></u>

NOTES TO THE CONDENSED CONSOLIDATED ACCOUNTS

3. Segment Information (continued)

	Unaudited Nine months ended 30 Sept 2003				
	Cash Market \$'000	Derivatives Market \$'000	Clearing Business \$'000	Information Services \$'000	Group \$'000
Income	571,617	239,222	396,663	193,661	1,401,163
Costs	<u>451,536</u>	<u>141,221</u>	<u>268,448</u>	<u>73,062</u>	<u>934,267</u>
Segment results	120,081	98,001	128,215	120,599	466,896
Share of profits less losses of associated companies	<u>10</u>	<u>-</u>	<u>4,637</u>	<u>-</u>	<u>4,647</u>
Segment profits before taxation	120,091	98,001	132,852	120,599	471,543
Taxation					<u>(67,247)</u>
Profit attributable to shareholders					<u><u>404,296</u></u>

The **Cash Market** business mainly refers to the operations of the Stock Exchange, which covers all products traded on the cash market platforms, such as equities, debt securities, unit trusts, warrants and rights. Currently, the Group operates two cash market platforms, the Main Board and the Growth Enterprise Market. The major sources of income of the business are trading fees, trading tariff and listing fees. Direct costs of Listing Function (which were previously included under the Others Segment) are treated as segment costs under the Cash Market. Comparatives for 2003 have been reclassified retrospectively to conform to this practice. Costs of Listing Function are further explained in note 5.

The **Derivatives Market** business refers to the derivatives products traded on the Futures Exchange and stock options traded on the Stock Exchange, which includes the provision and maintenance of trading platforms for a range of derivatives products, such as equity and interest rate futures and options. Its income mainly comprises trading fees and net interest income on the margin funds received.

The **Clearing Business** refers to the operations of the three Clearing Houses, namely Hong Kong Securities Clearing Company Limited (HKSCC), The SEHK Options Clearing House Limited (SEOCH) and HKFE Clearing Corporation Limited (HKCC), which are responsible for clearing, settlement and custodian activities and the related risk management of the cash and derivatives markets operated by the Group. Its income is derived primarily from interest earned on the Clearing House Funds and fees from providing clearing, settlement, depository and nominee services.

NOTES TO THE CONDENSED CONSOLIDATED ACCOUNTS

3. Segment Information (continued)

The **Information Services** business is responsible for developing, promoting, and compiling historical and statistical data, and sales and business development of market data. Its income comprises primarily income from sale of Cash Market and Derivatives Market information. Since Information Services activities share similar business risks as the Cash Market and Derivatives Market, results of Information Services activities were previously grouped under the two business segments based on the nature of their business risks (e.g. income from sales of Cash Market information under the Cash Market). As Information Services activities generate a significant amount of income for the Group, from year ended 31 December 2003 onwards, their results are disclosed separately under Information Services. Accordingly, comparatives for 2003 have been reclassified to conform to the new disclosure.

In addition to the above, central income (mainly investment income of Corporate Funds) and central costs (mainly costs of the support functions that centrally provide services to all of the business segments) are allocated to the business segments and included in the segment income and costs. Accordingly, comparatives for 2003 have been reclassified to conform to this practice.

4. Trading Fees and Trading Tariff

	Unaudited Nine months ended 30 Sept		Unaudited Three months ended 30 Sept	
	2004	2003	2004	2003
	\$'000	\$'000	\$'000	\$'000
Trading fees and trading tariff are derived from:				
Securities traded on the Cash Market	328,087	186,928	91,280	88,350
Derivatives contracts traded on the Derivatives Market	166,523	136,294	56,158	50,363
	<u>494,610</u>	<u>323,222</u>	<u>147,438</u>	<u>138,713</u>

NOTES TO THE CONDENSED CONSOLIDATED ACCOUNTS

5. Stock Exchange Listing Fees

Stock Exchange listing fees comprise the following:

Income	Unaudited Nine months ended 30 Sept 2004			Unaudited Nine months ended 30 Sept 2003		
	Equity \$'000	Debt & derivatives \$'000	Total \$'000	Equity \$'000	Debt & derivatives \$'000	Total \$'000
Annual listing fees	185,750	1,533	187,283	175,066	2,464	177,530
Initial listing fees	31,850	40,155	72,005	37,275	20,883	58,158
Prospectus vetting fees	2,240	-	2,240	2,095	-	2,095
Other listing fees	5,986	3,800	9,786	4,859	-	4,859
	<u>225,826</u>	<u>45,488</u>	<u>271,314</u>	<u>219,295</u>	<u>23,347</u>	<u>242,642</u>

Income	Unaudited Three months ended 30 Sept 2004			Unaudited Three months ended 30 Sept 2003		
	Equity \$'000	Debt & derivatives \$'000	Total \$'000	Equity \$'000	Debt & derivatives \$'000	Total \$'000
Annual listing fees	63,154	465	63,619	58,024	700	58,724
Initial listing fees	10,100	12,007	22,107	11,900	9,323	21,223
Prospectus vetting fees	385	-	385	945	-	945
Other listing fees	1,513	720	2,233	1,691	-	1,691
	<u>75,152</u>	<u>13,192</u>	<u>88,344</u>	<u>72,560</u>	<u>10,023</u>	<u>82,583</u>

Listing fee income is fees paid by issuers to enable them to gain access to the Stock Exchange and enjoy the privileges and facilities by being admitted, listed and traded on the Stock Exchange.

	Unaudited Nine months ended 30 Sept 2004		Unaudited Three months ended 30 Sept 2003	
	\$'000	\$'000	\$'000	\$'000
Costs of Listing Function				
Staff costs and related expenses	79,811	72,319	28,692	23,095
Information technology and computer maintenance expenses	2,137	1,826	663	649
Premises expenses	6,038	6,496	2,181	2,098
Legal and professional fees	2,789	11,748	812	1,613
Depreciation and amortisation	11,854	10,789	3,449	3,883
Payment to SFC under dual filing regime	15,000	10,000	5,000	5,000
Other operating expenses	5,885	4,316	1,595	1,260
	<u>123,514</u>	<u>117,494</u>	<u>42,392</u>	<u>37,598</u>

NOTES TO THE CONDENSED CONSOLIDATED ACCOUNTS

5. Stock Exchange Listing Fees (continued)

The costs listed above are regulatory in nature, which comprise direct costs of the Listing Function on vetting IPOs and enforcing the Listing Rules, disseminating information relating to listed companies, and payments to the Securities and Futures Commission (the SFC) under the dual filing regime. Other indirect costs, comprising costs incurred by other units on building the reputation of the Stock Exchange (e.g. marketing and promotion, brand-building, and providing an efficient market infrastructure and market access facilities) to attract issuers to list on the Stock Exchange, which contribute to the Stock Exchange listing fee income above, are not included as they are part and parcel of the activities of the Group and cannot be separately quantified. Moreover, the costs do not cover costs of support services and other central overheads attributable to the Listing Function.

NOTES TO THE CONDENSED CONSOLIDATED ACCOUNTS

6. Investment Income

	Unaudited Nine months ended 30 Sept		Unaudited Three months ended 30 Sept	
	2004 \$'000	2003 \$'000	2004 \$'000	2003 \$'000
Interest income				
- bank deposits	18,029	49,655	9,001	16,539
- listed securities	28,008	31,281	9,383	9,348
- unlisted securities	66,057	80,806	21,029	24,240
	<u>112,094</u>	<u>161,742</u>	<u>39,413</u>	<u>50,127</u>
Interest expenses	<u>(314)</u>	<u>(1,836)</u>	<u>(195)</u>	<u>(867)</u>
Net interest income	<u>111,780</u>	<u>159,906</u>	<u>39,218</u>	<u>49,260</u>
Accommodation income on cash margin deposits in non-contract settlement currencies and securities deposited by Participants as alternatives to cash deposits of the margin funds	<u>4,361</u>	<u>11,776</u>	<u>572</u>	<u>3,107</u>
Non-interest investment income / (loss)				
Net realised and unrealised gain/(loss) on investments (note a)				
- listed trading and non-trading securities (note b)	52,736	30,295	42,246	7,065
- unlisted trading and non-trading securities	(2,183)	7,273	3,631	(6,274)
- exchange difference	(2,723)	11,542	2,355	(7,668)
	<u>47,830</u>	<u>49,110</u>	<u>48,232</u>	<u>(6,877)</u>
Dividend income				
- listed non-trading securities – Singapore Exchange Limited	1,070	1,049	-	-
- listed trading securities	5,251	3,346	1,899	1,407
	<u>6,321</u>	<u>4,395</u>	<u>1,899</u>	<u>1,407</u>
Total non-interest investment income/(loss)	<u>54,151</u>	<u>53,505</u>	<u>50,131</u>	<u>(5,470)</u>
Total investment income	<u>170,292</u>	<u>225,187</u>	<u>89,921</u>	<u>46,897</u>
Total investment income is derived from:				
Corporate Funds (note c)	111,140	146,594	66,914	22,282
Margin funds	51,697	63,449	20,281	20,361
Clearing House Funds	7,455	15,144	2,726	4,254
	<u>170,292</u>	<u>225,187</u>	<u>89,921</u>	<u>46,897</u>

(a) Includes net realised gain on disposal of non-trading securities of Corporate Funds, margin funds and Clearing House Funds of \$24,942,000 (2003: \$6,852,000) and \$24,841,000 (2003: \$266,000) for the nine months ended 30 September 2004 and three months ended 30 September 2004 respectively, of which \$26,427,000 (2003: \$3,763,000) and \$26,326,000 (2003: \$Nil) respectively have been previously recognised in investment revaluation reserve.

(b) Includes profit on sale of Singapore Exchange Limited of \$24,841,000 in July 2004 (2003: \$Nil).

(c) Investment income derived from Corporate Funds includes investment income of Compensation Fund Reserve Account of \$412,000 (2003: \$579,000) and Cash and Derivatives Market Development Fund (CDMD Fund) of \$17,000 (2003: \$50,000) for the nine months ended 30 September 2004, and investment income of Compensation Fund Reserve Account of \$149,000 (2003: \$188,000) and CDMD Fund of \$5,000 (2003: \$6,000) for the three months ended 30 September 2004.

NOTES TO THE CONDENSED CONSOLIDATED ACCOUNTS

7. Other Income

	Unaudited Nine months ended 30 Sept		Unaudited Three months ended 30 Sept	
	2004 \$'000	2003 \$'000	2004 \$'000	2003 \$'000
Network, terminal user, dataline and software sub-license fees	86,731	73,872	29,924	25,256
Participants' subscription and application fees	25,778	27,405	8,548	8,862
Share registration services fees	1,383	862	354	135
Brokerage on direct IPO applications	11,288	535	2,906	402
Miscellaneous income	4,609	4,652	1,155	1,639
	<u>129,789</u>	<u>107,326</u>	<u>42,887</u>	<u>36,294</u>

8. Other Operating Expenses

	Unaudited Nine months ended 30 Sept		Unaudited Three months ended 30 Sept	
	2004 \$'000	2003 \$'000	2004 \$'000	2003 \$'000
Write-down of strategic investments (note a)	-	32,667	-	-
Retirement of redundant IT systems	157	9,943	-	97
Impairment of other property – revaluation deficit	-	4,411	-	-
Provision for/(reversal of provision for) doubtful debts	(614)	3,058	(744)	(516)
Insurance	12,389	9,002	4,144	3,018
Financial data subscription fees	5,822	6,636	1,889	2,132
Custodian and fund management fees	5,858	6,330	1,895	2,092
Bank charges	5,603	4,838	1,644	1,740
Repair and maintenance expenses	5,103	4,883	1,714	1,633
Other miscellaneous expenses	28,885	28,195	8,973	8,581
	<u>63,203</u>	<u>109,963</u>	<u>19,515</u>	<u>18,777</u>

- (a) Write-down of strategic investments for the nine-month period ended 30 September 2003 includes a 100 per cent write-down (\$32,303,000) of the Group's investment in BondsInAsia Limited under non-trading securities following a review of the Group's business strategy and operations.

NOTES TO THE CONDENSED CONSOLIDATED ACCOUNTS

9. Taxation

Taxation in the condensed consolidated profit and loss account represents:

	Unaudited Nine months ended 30 Sept		Unaudited Three months ended 30 Sept	
	2004 \$'000	2003 \$'000	2004 \$'000	2003 \$'000
Provision for Hong Kong Profits Tax (note a)	156,447	73,834	46,912	36,482
Underprovision in respect of prior years	-	1,170	-	1,170
	<u>156,447</u>	<u>75,004</u>	<u>46,912</u>	<u>37,652</u>
Deferred taxation (note b)	(16,133)	(8,836)	(7,660)	(5,965)
	<u>140,314</u>	<u>66,168</u>	<u>39,252</u>	<u>31,687</u>
Share of taxation of associated companies	1,890	1,079	545	326
	<u>142,204</u>	<u>67,247</u>	<u>39,797</u>	<u>32,013</u>

- (a) Hong Kong Profits Tax has been provided for at 17.5 per cent (2003: 17.5 per cent) on the estimated assessable profit for the period.
- (b) Deferred taxation for the nine months ended 30 September 2003 includes a one-off deferred tax charge of \$6,040,000, which arose from recomputing outstanding deferred tax liabilities carried forward from 2002 using the higher tax rate of 17.5 per cent and the adoption of Hong Kong Statement of Standard Accounting Practice 12: Income Taxes in 2003.

10. Earnings Per Share

The calculation of basic earnings per share for the nine months ended 30 September 2004 is based on the profit attributable to shareholders of \$755,668,000 (2003: \$404,296,000) and the weighted average of 1,054,436,372 shares (2003: 1,045,703,095) in issue during the period.

The calculation of basic earnings per share for the three months ended 30 September 2004 is based on the profit attributable to shareholders of \$250,675,000 (2003: \$189,910,000) and the weighted average of 1,056,502,998 shares (2003: 1,047,821,389) in issue during the period.

The employee share options outstanding did not have a material dilutive effect on the basic earnings per share for the nine-month and three-month periods ended 30 September 2004 and 30 September 2003.

11. Fixed Assets

The Group is heavily reliant on the capability and reliability of its computer systems for its business operations, including those required for its electronic trading platforms and for post-trading clearing and settlement services. The total cost of additions to fixed assets of the Group during the nine months to 30 September 2004 was \$17,274,000 (2003: \$23,688,000) of which \$16,424,000 (2003: \$20,968,000) or 95 per cent (2003: 89 per cent) was on computer systems, hardware and software. The total cost and net book value of disposals and write-offs of fixed assets during the nine months to 30 September 2004 were \$140,507,000 and \$172,000 respectively (2003: \$173,354,000 and \$10,147,000 respectively). During the nine-month period in 2004, the estimated useful life of hardware of trading and clearing systems was revised from three years to five years to better reflect the useful life of the equipment.

NOTES TO THE CONDENSED CONSOLIDATED ACCOUNTS

12. Investments in Associated Companies

	Unaudited at 30 Sept 2004 \$'000	Audited at 31 Dec 2003 \$'000
Share of net assets of associated companies	12,273	11,707
Goodwill on acquisition of shares in associated companies less amortisation and impairment (note a)	<u>20,308</u>	<u>22,295</u>
	<u><u>32,581</u></u>	<u><u>34,002</u></u>
 (a) Goodwill		
		\$'000
Cost		
At 1 Jan 2004 and 30 Sept 2004		<u><u>26,889</u></u>
Accumulated amortisation and impairment		
At 1 Jan 2004		4,594
Charge for the period		<u>1,987</u>
At 30 Sept 2004		<u><u>6,581</u></u>
Net book value		
At 30 Sept 2004		<u><u>20,308</u></u>
At 31 Dec 2003		<u><u>22,295</u></u>

(b) Goodwill is amortised on a straight-line basis over 10 years.

(c) Details of the unlisted associated companies as at 30 September 2004 are as follows:

<u>Name</u>	<u>Place of incorporation</u>	<u>Principal activities</u>	<u>Particulars of shares held</u>	<u>Interest held</u>
Computershare Hong Kong Investor Services Limited	Hong Kong	Provision of share registration services	5,854 Class A ordinary shares	24%
ADP Wilco Processing Services Limited	Hong Kong	Provision of transaction processing services to Stock Exchange Participants	6 Class B ordinary shares	30%

ADP Wilco Processing Services Limited has an accounting year end of 30 June, which is not coterminous with the Group's accounting year end.

NOTES TO THE CONDENSED CONSOLIDATED ACCOUNTS

13. Clearing House Funds

	Unaudited at 30 Sept 2004 \$'000	Audited at 31 Dec 2003 \$'000
Net asset values of the Clearing House Funds are as follows:		
HKSCC Guarantee Fund	372,512	371,289
SEOCH Reserve Fund	177,856	131,274
HKCC Reserve Fund	<u>1,004,123</u>	<u>1,048,767</u>
	<u>1,554,491</u>	<u>1,551,330</u>
Net assets of the Clearing House Funds are composed of:		
Unlisted non-trading securities, at fair value		
- debt securities	125,135	125,643
Contributions receivable from Clearing Participants fully secured by bank guarantees	123,073	92,234
Bank balances and time deposits	<u>1,320,824</u>	<u>1,349,644</u>
	1,569,032	1,567,521
Less: Other liabilities	<u>(14,541)</u>	<u>(16,191)</u>
	<u>1,554,491</u>	<u>1,551,330</u>
The Clearing House Funds are funded by:		
Clearing Participants' contributions		
- cash	863,179	891,811
- bank guarantees	123,073	92,234
Clearing houses' contributions	320,200	320,200
Forfeiture of defaulted Clearing Participants' contributions	1,928	1,928
Accumulated investment income net of expenses included in designated reserves attributable to		
- Clearing Participants' contributions	184,962	183,305
- Clearing houses' contributions	60,564	60,233
Revaluation reserve (note 20(c))	<u>585</u>	<u>1,619</u>
	<u>1,554,491</u>	<u>1,551,330</u>

The HKSCC Guarantee Fund provides resources to enable HKSCC to discharge the liabilities and obligations of defaulting Broker Participants in Central Clearing and Settlement System (CCASS) arising from their Stock Exchange trades accepted for settlement on the Continuous Net Settlement (CNS) basis and defective securities deposited into CCASS. The SEOCH Reserve Fund and the HKCC Reserve Fund were established for the exclusive purpose of supporting SEOCH and HKCC to fulfil their counterparty obligations in the event that one or more of their Clearing Participants fail to meet their obligations to SEOCH and HKCC respectively.

NOTES TO THE CONDENSED CONSOLIDATED ACCOUNTS

13. Clearing House Funds (continued)

For the HKSCC Guarantee Fund, investment income was insufficient to cover the fund's expenses during the nine months ended 30 September 2004 and a loss of \$4,475,000 (2003: \$1,014,000) arose. Accumulated losses of \$6,737,000 were included in the Group's retained earnings as at 30 September 2004 (31 December 2003: \$2,262,000). Future surplus investment income net of expenses of the fund will be offset against such accumulated losses before appropriation from the Group's retained earnings to the fund.

14. Compensation Fund Reserve Account

The SFC is responsible for maintaining the Unified Exchange Compensation Fund (Compensation Fund). By virtue of Schedule 10 of the Securities and Futures Ordinance (SFO), the Stock Exchange's obligation under the repealed Securities Ordinance (SO) to deposit with the SFC and keep deposited \$50,000 in respect of each Stock Exchange Trading Right in the Compensation Fund remains. The Stock Exchange maintains an account known as the Compensation Fund Reserve Account for all receipts and payments in relation to the Compensation Fund under the Rules of the Exchange, in particular the following:

- (a) The interest received from the SFC on the statutory deposits paid in respect of each Stock Exchange Trading Right into the Compensation Fund maintained by the SFC;
- (b) Amounts received or paid out in relation to each of the Stock Exchange Trading Rights granted or revoked by the Stock Exchange respectively; and
- (c) Amounts reserved for the replenishment of the Compensation Fund.

The Compensation Fund is further explained in note 25(a).

15. Cash and Derivatives Market Development Fund

The CDMD Fund was established by the cash received from The Hong Kong Futures Guarantee Corporation Limited (the former clearing house of the Futures Exchange) for the purpose of providing funding for the development and betterment of the cash and derivatives markets in Hong Kong.

During the period ended 30 September 2004, \$505,000 (2003: \$Nil) of the CDMD Fund was utilised and transferred from the CDMD Fund reserve to the Group's retained earnings (note 22) for marketing expenses of certain derivatives and clearing products. The remaining sum of \$412,000 is expected to be utilised in the next twelve months.

NOTES TO THE CONDENSED CONSOLIDATED ACCOUNTS

16. Margin Funds on Derivatives Contracts

	Unaudited at 30 Sept 2004 \$'000	Audited at 31 Dec 2003 \$'000
The margin funds comprise:		
SEOCH Clearing Participants' margin funds	1,328,344	1,083,679
HKCC Clearing Participants' margin funds	<u>8,337,503</u>	<u>6,790,831</u>
	<u>9,665,847</u>	<u>7,874,510</u>
The assets of the margin funds comprise:		
Bank balances and time deposits	5,498,341	4,900,011
Listed securities deposited as alternatives to cash deposits, at market value	928,789	805,430
Listed non-trading securities, at fair value		
- debt securities	262,281	102,780
Unlisted non-trading securities, at fair value		
- debt securities	<u>2,976,436</u>	<u>2,066,289</u>
	<u>9,665,847</u>	<u>7,874,510</u>
The Group's liabilities in respect of the margin funds are as follows:		
Margin deposits and securities received from SEOCH and HKCC Participants on derivatives contracts	<u>9,665,847</u>	<u>7,874,510</u>

17. Accounts Receivable, Prepayments and Deposits/Accounts Payable, Accruals and Other Liabilities

The Group's accounts receivable, prepayments and deposits and accounts payable, accruals and other liabilities amounted to \$2,965,658,000 (31 December 2003: \$4,644,680,000) and \$3,199,220,000 (31 December 2003: \$4,779,904,000) respectively. These mainly represent the Group's CNS money obligations under the T+2 settlement cycle. The Group's CNS money obligations receivable represents 90 per cent (31 December 2003: 87 per cent) of the total accounts receivable, prepayments and deposits. CNS money obligations payable represents 83 per cent (31 December 2003: 84 per cent) of the total accounts payable, accruals and other liabilities. CNS money obligations mature within two days as they are due for settlement two days after the trade date. The majority of the remaining accounts receivable, prepayments, deposits, accounts payable, accruals and other liabilities will mature within three months.

NOTES TO THE CONDENSED CONSOLIDATED ACCOUNTS

18. Provisions

	Reinstatement costs \$'000	Employee benefit costs \$'000	Total \$'000
At 1 Jan 2004	24,578	23,525	48,103
Provision for the period	20	25,245	25,265
Amount used during the period	-	(22,344)	(22,344)
Amount paid during the period	(213)	(2,754)	(2,967)
Unused amount reversed during the period	(281)	-	(281)
At 30 Sept 2004	<u>24,104</u>	<u>23,672</u>	<u>47,776</u>
		Unaudited at 30 Sept 2004 \$'000	Audited at 31 Dec 2003 \$'000
Analysis of provisions:			
Current		23,692	25,011
Non-current		24,084	23,092
		<u>47,776</u>	<u>48,103</u>

19. Share Capital and Share Premium

		Unaudited at 30 Sept 2004 \$'000	Audited at 31 Dec 2003 \$'000	
Authorised:				
2,000,000,000 shares of \$1 each		<u>2,000,000</u>	<u>2,000,000</u>	
Issued and fully paid:				
	No. of shares of \$1 each	Share capital \$'000	Share premium \$'000	Total \$'000
At 1 Jan 2003	1,043,580,846	1,043,581	19,012	1,062,593
Shares issued under employee share option schemes	<u>5,418,000</u>	<u>5,418</u>	<u>35,326</u>	<u>40,744</u>
At 31 Dec 2003	1,048,998,846	1,048,999	54,338	1,103,337
Shares issued under employee share option schemes	<u>7,594,000</u>	<u>7,594</u>	<u>49,425</u>	<u>57,019</u>
At 30 Sept 2004	<u>1,056,592,846</u>	<u>1,056,593</u>	<u>103,763</u>	<u>1,160,356</u>

NOTES TO THE CONDENSED CONSOLIDATED ACCOUNTS

19. Share Capital and Share Premium (continued)

Under the Pre-Listing Share Option Scheme (Pre-Listing Scheme) of HKEx, share options were granted to employees on 20 June 2000 which are exercisable between 6 March 2002 and 30 May 2010 at an exercise price of \$7.52 per share. Following the declaration of a special dividend and final dividend for 2003, at the annual general meeting (AGM) held on 31 March 2004, shareholders of HKEx approved the adjustments to the subscription price and the contract size of the outstanding options granted under the Pre-Listing Scheme. The subscription price of the shares issuable under the options granted was adjusted from \$7.52 per share to \$6.88 per share and the aggregate contract size of the options granted but not yet exercised as at 31 March 2004 was adjusted from 6,615,465 shares to 7,288,668 shares.

Under the Post-Listing Share Option Scheme (Post-Listing Scheme) of HKEx, share options were granted to:

- (a) an executive Director on 2 May 2003 which are exercisable between 2 May 2005 and 1 May 2013 at an exercise price of \$9.05 per share;
- (b) an employee on 14 August 2003 which are exercisable between 14 August 2005 and 13 August 2013 at an exercise price of \$13.60 per share;
- (c) an employee on 18 August 2003 which are exercisable between 18 August 2005 and 17 August 2013 at an exercise price of \$13.65 per share;
- (d) an employee on 15 January 2004 which are exercisable between 15 January 2006 and 14 January 2014 at an exercise price of \$18.90 per share;
- (e) a number of employees on 31 March 2004 which are exercisable between 31 March 2006 and 30 March 2014 at an exercise price of \$16.96 per share; and
- (f) an employee on 17 May 2004 which are exercisable between 17 May 2006 and 16 May 2014 at an exercise price of \$15.91 per share.

At the AGM held on 31 March 2004, shareholders of HKEx approved the adjustments to the subscription price and the contract size of the options granted under the Post-Listing Scheme in (a) to (d) above that were not yet exercised prior to the AGM. The adjustments made to the first four option grants under the Post-Listing Scheme are as follows:

Date of grant	Exercise price after adjustment	Number of shares issuable under the options granted before adjustment	Number of shares issuable under the options granted after adjustment
2 May 2003	\$8.28	3,000,000	3,280,000
14 August 2003	\$12.45	1,000,000	1,094,000
18 August 2003	\$12.49	1,800,000	1,968,000
15 January 2004	\$17.30	1,000,000	1,094,000

During the period, Pre-Listing employee share options were exercised to subscribe for 7,594,000 shares (year ended 31 December 2003: 5,418,000) in HKEx at a consideration of \$7.52 per share on or before 31 March 2004 and \$6.88 per share after 31 March 2004, of which \$1.00 per share was credited to share capital and the balance was credited to the share premium account.

NOTES TO THE CONDENSED CONSOLIDATED ACCOUNTS

19. Share Capital and Share Premium (continued)

Movements of the employee share options during the period were as follows:

	Number of shares issuable under the employee share options outstanding as at 1 Jan 2004	Number of shares issuable under the new employee share options granted during the period	Number of shares issuable under the employee share options granted pursuant to the adjustment approved at the AGM	Number of shares issuable under the employee share options lapsed during the period	Number of shares issued under the employee share options exercised during the period	Number of shares issuable under the employee share options outstanding as at 30 Sept 2004
Pre-Listing Scheme	14,171,626	-	673,203	(362,829)	(7,594,000)	6,888,000
Post-Listing Scheme	5,800,000	6,888,000	636,000	(44,000)	-	13,280,000
	<u>19,971,626</u>	<u>6,888,000</u>	<u>1,309,203</u>	<u>(406,829)</u>	<u>(7,594,000)</u>	<u>20,168,000</u>

Currently, when the employee share options are exercised and new shares are issued, the share capital is increased by the nominal value of the new shares issued and the share premium account is increased by the remainder of the proceeds. HKEx has not expensed the employee share options to the profit and loss account. Had all the outstanding employee share options been fully exercised on 30 September 2004, the Group would have received \$230,578,900 in proceeds. The market value of the shares issued based on the closing price of \$17.75 per share on that date would have been \$357,982,000. The employees concerned under the Pre-Listing Scheme would have made a gain of \$10.87 per share, or, in aggregate, \$74,872,560. The executive Director concerned under the Post-Listing Scheme would have made a gain of \$9.47 per share, or, in aggregate, \$31,061,600. The employees concerned under the Post-Listing Scheme granted on 14 August 2003, 18 August 2003, 15 January 2004, 31 March 2004 and 17 May 2004 would have made a gain of \$5.30 per share, or, in aggregate, \$5,798,200, \$5.26 per share, or, in aggregate, \$10,351,680, \$0.45 per share, or in aggregate, \$492,300, \$0.79 per share, or in aggregate, \$4,458,760 and \$1.84 per share, or, in aggregate, \$368,000 respectively.

In April 2004, the Hong Kong Institute of Certified Public Accountants (formerly Hong Kong Society of Accountants) issued a Hong Kong Financial Reporting Standard, HKFRS2: Share-based Payment, which covers the accounting treatment for employee share options. The new HKFRS2 is effective for accounting periods beginning on or after 1 January 2005.

NOTES TO THE CONDENSED CONSOLIDATED ACCOUNTS

20. Revaluation Reserves

	Unaudited at 30 Sept 2004 \$'000	Audited at 31 Dec 2003 \$'000
Investment properties revaluation reserve (note b)	1,771	1,771
Other properties revaluation reserve (note b)	28,905	10,668
Investment revaluation reserve (note c)	<u>(12,429)</u>	<u>33,992</u>
	<u>18,247</u>	<u>46,431</u>

- (a) The revaluation reserves are segregated for their respective specific purposes and are stated net of applicable deferred taxes.
- (b) Properties are revalued on a six-monthly basis at the end of June and December each year.
- (c) Includes \$585,000, \$3,000 and \$127,000 (31 December 2003: \$1,619,000, \$11,000 and \$318,000 respectively) of gross revaluation surplus which are attributable to investments of the Clearing House Funds, the CDMD Fund and the Compensation Fund Reserve Account respectively. The significant decrease in investment revaluation reserve is mainly due to the decrease in fair value of non-trading securities of the margin funds and the disposal of the investment in Singapore Exchange Limited.

21. Designated Reserves

	Unaudited at 30 Sept 2004 \$'000	Audited at 31 Dec 2003 \$'000
Clearing House Funds reserves		
- HKSCC Guarantee Fund reserve	255,912	255,912
- SEOCH Reserve Fund reserve	48,644	48,571
- HKCC Reserve Fund reserve	<u>263,098</u>	<u>261,183</u>
	567,654	565,666
Compensation Fund Reserve Account reserve	36,953	36,541
CDMD Fund reserve	409	914
Development reserve (note b)	<u>83,377</u>	<u>86,536</u>
	<u>688,393</u>	<u>689,657</u>

- (a) These reserves are segregated for their respective purposes.
- (b) Development reserve was set aside for systems development for the Stock Exchange. During the nine-month period ended 30 September 2004, \$3,159,000 (2003: \$39,364,000) of the reserve was utilised and transferred to the Group's retained earnings (note 22) for funding systems development projects relating to the securities market.

NOTES TO THE CONDENSED CONSOLIDATED ACCOUNTS

22. Retained Earnings

	Unaudited at 30 Sept 2004 \$'000	Audited at 31 Dec 2003 \$'000
At 1 Jan		
Retained earnings	1,560,940	3,221,321
Proposed and declared dividends	2,202,898	448,740
Profit for the period/year (note a)	755,668	691,765
Investment income net of expenses of Clearing House Funds for the period/year transferred to Clearing House Funds reserves	(1,988)	(8,430)
Investment income net of expenses of Compensation Fund Reserve Account for the period/year transferred to Compensation Fund Reserve Account reserve	(412)	(714)
Transfer from CDMD Fund reserve (note 15)	505	-
Transfer from Development reserve (note 21)	3,159	49,226
Dividends paid:		
2004/2003 interim dividend	(454,283)	(188,452)
2003 special and final dividends/2002 final dividend	(2,202,898)	(448,740)
Dividend on shares issued for employee share options exercised after declaration of 2003 special and final dividends/2002 final dividend	(15,661)	(647)
Dividend on shares issued for employee share options exercised after declaration of 2004/2003 interim dividend	(8)	(231)
At 30 Sept/31 Dec	<u>1,847,920</u>	<u>3,763,838</u>
Representing:		
Retained earnings	1,847,920	1,560,940
Proposed and declared dividends	-	2,202,898
At 30 Sept/31 Dec	<u>1,847,920</u>	<u>3,763,838</u>

- (a) The Group's profit for the nine-month period/year includes a net deficit attributable to investment income net of expenses of the Clearing House Funds, Compensation Fund Reserve Account and CDMD Fund for an aggregate amount of \$2,058,000 (year ended 31 December 2003: surplus of \$6,938,000).

NOTES TO THE CONDENSED CONSOLIDATED ACCOUNTS

23. Commitments

	Unaudited at 30 Sept 2004 \$'000	Audited at 31 Dec 2003 \$'000
Commitments in respect of capital expenditures:		
Contracted but not provided for	7,974	18,359
Authorised but not contracted for	<u>35,440</u>	<u>72,275</u>
	<u><u>43,414</u></u>	<u><u>90,634</u></u>

The commitments in respect of capital expenditures were mainly for the development and purchases of computer systems.

24. Financial Risk Management

When seeking to optimise returns on its funds available for investment, the Group may invest in non-HKD securities from time to time. Forward foreign exchange contracts are used to hedge the currency exposures of the Group's non-HKD investments and liabilities to mitigate risks arising from fluctuations in exchange rates. As at 30 September 2004, the total nominal value of outstanding forward foreign exchange contracts amounted to HK\$296 million (31 December 2003: HK\$322 million). All contracts will mature within three months.

NOTES TO THE CONDENSED CONSOLIDATED ACCOUNTS

25. Contingent Liabilities

- (a) The Compensation Fund is a fund set up under the repealed SO for the purpose of compensating any person dealing with a Stock Exchange Participant (other than another Stock Exchange Participant) for any pecuniary losses suffered as a result of a default of the Stock Exchange Participant. According to section 109(3) of the SO, the maximum compensation amount is \$8 million for each Stock Exchange Participant's default. Under section 113(5A) of the SO, the Stock Exchange may, upon satisfying certain conditions, with the approval of the SFC, allow an additional payment to the successful claimants before apportionment. Under section 107(1) of the SO, the Stock Exchange has contingent liabilities to the Compensation Fund as it shall replenish the Compensation Fund upon the SFC's request to do so. The amounts to be replenished should be equal to the amount paid in connection with the satisfaction of the claims, including any legal and other expenses paid or incurred in relation to the claims but capped at \$8 million per default. As at 30 September 2004, there were outstanding claims received in respect of 10 defaulted Stock Exchange Participants (31 December 2003: 13).

Pursuant to the SFO, the Stock Exchange issued a notice on 3 April 2003 inviting for claims against the Compensation Fund in relation to any default of a Stock Exchange Participant occurring before 1 April 2003. The claims period expired on 3 October 2003 and no claims had been received in response to that notice. Claims made after the claims period shall, unless the Stock Exchange otherwise determines, be barred. Until 30 September 2004, no such claims had been received.

Following the implementation of the new compensation arrangements under the SFO, an Investor Compensation Fund has been established to replace the existing Compensation Fund, the Commodity Exchange Compensation Fund and the Dealers' Deposit Schemes for non-exchange participant dealers. Pursuant to the SFO, Exchange Participants are no longer required to make deposits to the Investor Compensation Fund and the Stock Exchange is not required to replenish the Investor Compensation Fund. Hence, deposits to the Commodity Exchange Compensation Fund had been returned to the Futures Exchange by the SFC in January 2004. The Futures Exchange had in turn reimbursed holders of Futures Exchange Trading Rights their contributions to the Commodity Exchange Compensation Fund. Similarly, deposits to the Compensation Fund would be returned to the Stock Exchange in accordance with SFO pending completion of the determination of the outstanding claims and replenishment to the Compensation Fund.

- (b) The Stock Exchange has undertaken to indemnify the Collector of Stamp Revenue against any loss of revenue resulting from any underpayment or default or delay in payment of stamp duty by its Participants, up to \$200,000 in respect of default of any one Participant. In the unlikely event that all of its 435 trading Participants as at 30 September 2004 (31 December 2003: 437) default, the maximum contingent liability of the Stock Exchange under the indemnity will amount to \$87 million (31 December 2003: \$87 million).
- (c) HKEx gave an undertaking on 6 March 2000 in favour of HKSCC to contribute an amount not exceeding \$50 million in the event of HKSCC being wound up while it is a wholly-owned subsidiary of HKEx or within one year after HKSCC ceases to be a wholly-owned subsidiary of HKEx, for payment of the debts and liabilities of HKSCC contracted before HKSCC ceases to be a wholly-owned subsidiary of HKEx, and for the costs, charges and expenses of winding up.

NOTES TO THE CONDENSED CONSOLIDATED ACCOUNTS

26. Material Related Party Transactions

Certain Directors of HKEx are directors and/or shareholders of (i) Stock Exchange Participants and Futures Exchange Participants (Exchange Participants) and Clearing Participants; (ii) companies listed on the Stock Exchange; and (iii) Exchange Participants for buying shares on behalf of HKSCC. Securities and derivatives contracts traded by, and fees levied on, these Exchange Participants and Clearing Participants, fees levied on these listed companies and fees paid to these Exchange Participants for buying shares on behalf of HKSCC are all undertaken in the ordinary course of business of the Group on the standard terms and conditions applicable to all other Exchange Participants and Clearing Participants, listed companies and Exchange Participants for buying shares on behalf of HKSCC.

In addition to the above, on 5 February 2003, the Futures Exchange as the tenant entered into a tenancy agreement (the Lease) with Shine Hill Development Limited (Shine Hill) as the landlord. The Futures Exchange is a wholly-owned subsidiary of HKEx. Shine Hill is a subsidiary of Great Eagle Holdings Limited (Great Eagle). Dr LO Ka Shui is an independent non-executive Director of HKEx and the managing director of Great Eagle. The Lease was an arm's length transaction entered into on normal commercial terms. The rental payments, including air conditioning and cleaning service charges for the nine-month period ended 30 September 2004 amounted to \$3,325,484 (2003: \$3,240,781).

During the period, share registration service fees amounted to \$283,744 (2003: \$463,687) were paid to and dividends and loan interest amounted to \$8,400,490 and \$Nil respectively (2003: \$4,800,280 and \$20,652 respectively) were received from an associated company, Computershare Hong Kong Investor Services Limited.

During the nine months ended 30 September 2004, bank charges of \$3,572,171 (2003: \$2,256,318) were paid to The Hongkong & Shanghai Banking Corporation Limited where Dr LO Ka Shui was a non-executive director.

During the corresponding period in 2003, consultancy fee of \$862,285 was paid to Goldman Sachs (Asia) LLC where Mr FRESHWATER, Timothy George, an independent non-executive Director of HKEx, is a director. The transaction was carried out in the ordinary course of business on normal commercial terms.

Save as aforesaid, HKEx had entered into other transactions with companies where there are common directors but the amount was immaterial.

NOTES TO THE CONDENSED CONSOLIDATED ACCOUNTS

27. Off Balance Sheet Risks

In the normal course of business, the clearing houses of the Group, HKSCC, SEIOCH and HKCC, act as the counterparties to eligible trades concluded on the Stock Exchange and the Futures Exchange through the novation of the obligations of the buyers and sellers. HKSCC is also responsible for the good title to the securities deposited and accepted in the CCASS depository. As a result, the Group has considerable market risk and credit risk since the Participants' ability to honour their obligations in respect of their trades and securities deposited may be adversely impacted by economic conditions affecting the cash and derivatives markets. If the Participants default on their obligations on settlement or there are defects in the title of securities deposited and accepted in the CCASS depository, the Group could be exposed to potential risks not otherwise accounted for in these condensed consolidated accounts.

The Group mitigates its exposure to the risks described above by requiring the Participants to meet the Group's established financial requirements and criteria for admission as Participants, monitoring compliance with risk management measures such as position limits established by the Group and requiring Clearing Participants to contribute to the Clearing House Funds set up by HKSCC, SEIOCH and HKCC. HKSCC also retains recourse against those Participants whose securities are deposited and accepted in the CCASS depository. Moreover, insurance has been taken out by the Group to cover the risks.

28. Comparative Figures

- (a) The comparative figure of time deposits with maturity over one year has been reclassified to non-current assets in order to conform with the current period's presentation.
- (b) For non-trading securities sold or matured, changes in fair value during the period up to disposal or maturity are no longer recognised as "change in fair value of non-trading securities" during the period and accordingly not reversed in the "realisation of change in fair value of non-trading securities on maturity or disposal" (there is no impact on the profit and loss account). The 2003 comparatives for "change in fair value of non-trading securities" and "realisation of change in fair value of non-trading securities on maturity or disposal" in the Condensed Consolidated Statement of Changes in Equity have been amended to conform to the current period's presentation.

OTHER INFORMATION

(Financial figures are expressed in Hong Kong dollars)

Outstanding Share Options

Details of the share options outstanding as at 30 September 2004 under the Pre-Listing Scheme and the Post-Listing Scheme were as follows:

(a) Pre-Listing Scheme

	Date of grant	Exercise price	Number of shares				Exercise period
			Issuable as at 1 January 2004	Issued during the nine months ended 30 September 2004	Lapsed during the nine months ended 30 September 2004	Issuable as at 30 September 2004	
Aggregate total for employees (note 1)	20 June 2000	\$6.88 (note 2)	14,171,626	7,594,000 (note 3)	362,829 (note 4)	6,888,000 (note 2)	6 March 2002 – 30 May 2010 (note 5)

(b) Post-Listing Scheme

Date of grant	Exercise price	Number of shares issuable under the options granted	Option value as at the date of grant	Number of shares			Exercise period
				Issued during the nine months ended 30 September 2004	Lapsed during the nine months ended 30 September 2004	Issuable as at 30 September 2004	
Director (note 6)							
2 May 2003	\$8.28 (note 7)	3,280,000 (note 7)	\$8,036,000 (note 8)	-	-	3,280,000	2 May 2005 – 1 May 2013 (note 9)
Employees (note 1)							
14 August 2003	\$12.45 (note 7)	1,094,000 (note 7)	\$4,561,980 (note 8)	-	-	1,094,000	14 August 2005 – 13 August 2013 (note 10)
18 August 2003	\$12.49 (note 7)	1,968,000 (note 7)	\$8,226,240 (note 8)	-	-	1,968,000	18 August 2005 – 17 August 2013 (note 11)
15 January 2004	\$17.30 (note 7)	1,094,000 (note 7)	\$6,564,000 (note 8)	-	-	1,094,000	15 January 2006 – 14 January 2014 (note 12)
31 March 2004 (note 13)	\$16.96 (note 14)	5,688,000	\$32,250,960 (note 8)	-	44,000 (note 15)	5,644,000	31 March 2006 – 30 March 2014 (note 16)
17 May 2004 (note 13)	\$15.91 (note 17)	200,000	\$1,156,000 (note 8)	-	-	200,000	17 May 2006 – 16 May 2014 (note 18)

Notes:

1. Employees working under employment contracts that were regarded as “continuous contracts” for the purpose of the Employment Ordinance of Hong Kong.
2. At the annual general meeting of HKEx held on 31 March 2004 (AGM), shareholders of HKEx approved the adjustments to the subscription price and the contract size of the unexercised options granted under the Pre-Listing Scheme. The subscription price of the shares issuable under the unexercised options granted under the Pre-Listing Scheme was adjusted from \$7.52 per share to \$6.88 per share. The aggregate contract size of the unexercised options granted was adjusted, resulting in the additional grant of 673,203 shares. After taking into account the shares issued and lapsed under the Pre-Listing Scheme during the nine months ended 30 September 2004, the number of shares issuable as at 30 September 2004 was 6,888,000.
3. The weighted average closing price immediately before the dates on which the options were exercised was \$20.07.
4. Options lapsed in accordance with the terms of the Pre-Listing Scheme due to resignation of employees.
5. Options granted are exercisable between 6 March 2002 and 30 May 2010, in tranches of 25 per cent each reaching 100 per cent as from 6 March 2005.
6. The option was granted to Mr Chow Man Yiu, Paul, a Director and the Chief Executive of HKEx.
7. At the AGM, shareholders approved the adjustments to the subscription price and the contract size of the unexercised options granted under the Post-Listing Scheme prior to the AGM. Adjustments made to the four unexercised options granted under the Post-Listing Scheme prior to the AGM are as follows:

Date of grant	Exercise price before adjustment	Exercise price after adjustment	Number of shares issuable under the options granted before adjustment	Number of shares issuable under the options granted after adjustment	Closing price immediately before the date on which the option was granted	Closing price immediately before the date on which the option was adjusted
2 May 2003	\$9.05	\$8.28	3,000,000	3,280,000	\$9.10	\$16.85
14 August 2003	\$13.60	\$12.45	1,000,000	1,094,000	\$13.95	\$16.85
18 August 2003	\$13.65	\$12.49	1,800,000	1,968,000	\$13.35	\$16.85
15 January 2004	\$18.90	\$17.30	1,000,000	1,094,000	\$19.00	\$16.85

8. According to the Binomial Option Pricing Model, the value of the options granted as at the date of grant and the revaluation of the adjusted options (as approved by shareholders at the AGM) were as follows:

	Date of grant					
	2 May 2003	14 August 2003	18 August 2003	15 January 2004	31 March 2004	17 May 2004
<u>Option value</u>						
Before adjustment	\$8,010,000	\$4,560,000	\$8,226,000	\$6,550,000	\$32,250,960	\$1,156,000
After adjustment	\$8,036,000	\$4,561,980	\$8,226,240	\$6,564,000	(note 13)	(note 13)
<u>Variables</u>						
Risk Free Rate (being the yield of 10-year Exchange Fund Notes)	4.3% as at 30 April 2003	4.84% as at 14 August 2003	4.76% as at 18 August 2003	3.96% as at 15 January 2004	3.78% as at 31 March 2004	4.55% as at 17 May 2004
Expected Volatility (annualised volatility for 1 year immediately preceding the grant date)	36%	36%	36%	34%	35%	37%
Expiration of the option	10 years from 2 May 2003	10 years from 14 August 2003	10 years from 18 August 2003	10 years from 15 January 2004	10 years from 31 March 2004	10 years from 17 May 2004
Expected ordinary dividend	5.6% (2003 prospective dividend yield of the shares as at 2 May 2003)	4.49% (2003 prospective dividend yield of the shares as at 14 August 2003)	4.47% (2003 prospective dividend yield of the shares as at 18 August 2003)	3.23% (2004 prospective dividend yield of the shares as at 15 January 2004)	3.59% (2004 prospective dividend yield of the shares as at 31 March 2004)	3.77% (2004 prospective dividend yield of the shares as at 17 May 2004)

The above calculation is based on the assumption of no material difference between the expected volatility over the whole life of the options and the historical volatility of the shares in HKEx over the respective periods.

The Binomial Option Pricing Model was developed to estimate the fair value of American style options. It is one of the commonly used models to estimate the fair value of an option which can be exercised before the expiry of the option period. The value of an option varies with different variables of certain subjective assumptions. Any change in variables so adopted may materially affect the estimation of the fair value of an option.

9. Option granted is exercisable between 2 May 2005 and 1 May 2013, in tranches of 25 per cent each reaching 100 per cent as from 2 May 2008.
10. Option granted is exercisable between 14 August 2005 and 13 August 2013, in tranches of 25 per cent each reaching 100 per cent as from 14 August 2008.
11. Option granted is exercisable between 18 August 2005 and 17 August 2013, in tranches of 25 per cent each reaching 100 per cent as from 18 August 2008.
12. Option granted is exercisable between 15 January 2006 and 14 January 2014, in tranches of 25 per cent each reaching 100 per cent as from 15 January 2009.
13. Options granted on or after 31 March 2004 under the Post-Listing Scheme, and are not subject to the adjustments as referred to in note 7.

14. The closing price immediately before the date on which the options were granted was \$16.85.
15. Options lapsed in accordance with the terms of the Post-Listing Scheme due to resignation of employees.
16. Options granted are exercisable between 31 March 2006 and 30 March 2014, in tranches of 25 per cent each reaching 100 per cent as from 31 March 2009.
17. The closing price immediately before the date on which the options were granted was \$15.55.
18. Options granted are exercisable between 17 May 2006 and 16 May 2014, in tranches of 25 per cent each reaching 100 per cent as from 17 May 2009.

Directors' and Chief Executive's Interests and Short Positions

As at 30 September 2004, the Directors, the Chief Executive and their respective associates had the following interests in the shares and underlying shares of HKEx, as recorded in the register maintained by HKEx pursuant to Section 352 of the SFO:

(i) Shares

Name of Director	Number of shares held			Total
	Personal Interests	Family Interests	Corporate Interests	
Lee Jor Hung, Dannis	-	-	1,610,000 <i>(note 1)</i>	1,610,000
David Michael Webb	2 <i>(note 2)</i>	2 <i>(note 3)</i>	6 <i>(note 4)</i>	10
John Estmond Strickland	18,000 <i>(note 5)</i>	-	-	18,000

Notes:

1. 1,610,000 shares were owned by DL Brokerage Limited, a private company beneficially wholly-owned by Mr Lee Jor Hung, Dannis, representing approximately 0.15 per cent of the issued share capital of HKEx.
2. The shares held by Mr David Michael Webb as beneficial owner represent approximately 0.00 per cent of the issued share capital of HKEx.
3. The shares were owned by the spouse of Mr David Michael Webb, representing approximately 0.00 per cent of the issued share capital of HKEx.
4. The shares were owned by Fundamental Consultants Limited, Member One Limited and Member Two Limited which are under the control of Mr David Michael Webb, representing approximately 0.00 per cent of the issued share capital of HKEx.
5. The shares held by Mr John Estmond Strickland as beneficial owner represent approximately 0.00 per cent of the issued share capital of HKEx.

(ii) Underlying Shares

As at 30 September 2004, the outstanding number of shares issuable under a share option granted pursuant to the Post-Listing Scheme to Mr Chow Man Yiu, Paul, a Director and the Chief Executive of HKEx, was 3,280,000, which represents approximately 0.31 per cent of the issued share capital of HKEx. The said option was granted on 2 May 2003, and is exercisable between 2 May 2005 and 1 May 2013 at an exercise price of \$8.28 per share. The number of shares issuable under the option granted and the exercise price have been adjusted in accordance with the resolution passed by shareholders at the AGM. Please refer to note 7 under “Outstanding Share Options” for more information.

Other than the holdings disclosed above, no interests and short positions were held or deemed or taken to be held under Part XV of the SFO by any Director or the Chief Executive of HKEx or their respective associates in the shares, underlying shares and debentures of HKEx or any of its associated corporations (within the meaning of Part XV of the SFO) which were required to be notified to HKEx and the Stock Exchange pursuant to Part XV of the SFO or pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers (Model Code) or which are required pursuant to Section 352 of the SFO to be entered in the register referred to therein. Nor any of the Directors and the Chief Executive (including their spouses and children under the age of 18) had, as at 30 September 2004, any interest in, or had been granted any right to subscribe for the securities and options of HKEx and its associated corporations within the meaning of the SFO, or had exercised any such rights.

Disclosable Interests and Short Positions of Shareholders under the SFO

As at 30 September 2004, J.P. Morgan Chase & Co and its controlled corporations were holding 63,935,154 shares of HKEx, representing approximately 6.05 per cent of the issued share capital of HKEx as recorded in the register required to be kept by HKEx under Section 336 of the SFO, of which 2,281,724 shares were held by J.P. Morgan Chase & Co and its controlled corporations as beneficial owner, 711,000 shares as investment manager, and 60,942,430 shares as a custodian corporation/approved lending agent pursuant to the Securities and Futures (Disclosure of Interests – Securities Borrowing and Lending) Rules.

Apart from the aforesaid, the Directors are not aware of any other party who was directly or indirectly interested in 5 per cent or more of the issued share capital of HKEx, as recorded in the register required to be kept by HKEx under Section 336 of the SFO.

Minority Controllers

Under the SFO, no person shall be or become a Minority Controller, i.e. a person who either alone or with any associate or associates, is entitled to exercise, or control the exercise of 5 per cent or more of the voting power at any general meeting of the recognised exchange controller, except with the approval in writing of the SFC after consultation with the Financial Secretary of the Hong Kong Special Administrative Region.

The SFC has so far granted approval to five entities to be Minority Controllers of HKEx, on the basis that the shares are held by them in custody for their clients.

As at 30 September 2004, the Minority Controllers were in aggregate holding 52.5 per cent of the issued share capital of HKEx (30 September 2003: 58.5 per cent).

Corporate Governance

HKEx is committed to building and maintaining high standards of corporate governance. None of the Directors of HKEx is aware of information that would reasonably indicate that HKEx is not, or was not for any part of the nine months ended 30 September 2004, in compliance with the Code of Best Practice as set out in Appendix 14 to the Listing Rules.

Members of the Board are independent non-executive Directors with the exception of the Chief Executive who is an ex-officio Board member and the only executive Director of HKEx. Three of the independent non-executive Directors are qualified accountants with substantial experience in financial matters and two of them are members of the Audit Committee.

The Audit Committee has reviewed the Group's unaudited condensed consolidated statements for the nine months ended 30 September 2004 in conjunction with HKEx's external auditors.

Management has appointed the external auditors to carry out certain agreed-upon procedures in accordance with Statement of Auditing Standards 710 "Engagements to perform agreed-upon procedures regarding financial information" issued by the Hong Kong Institute of Certified Public Accountants on the unaudited condensed consolidated statements for the nine months ended 30 September 2004.

Compliance with the Model Code

HKEx has adopted the Model Code as set out in Appendix 10 to the Listing Rules. All Directors have confirmed, following specific enquiry by HKEx, that they fully complied with the required standard as set out in the Model Code throughout the review period.

Purchase, Sale or Redemption of HKEx's Listed Securities

During the nine months ended 30 September 2004, HKEx had not redeemed, and neither HKEx nor any of its subsidiaries had purchased or sold any of HKEx's listed securities.

By Order of the Board
Hong Kong Exchanges and Clearing Limited
LEE Yeh Kwong, Charles
Chairman

Hong Kong, 10 November 2004